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Charles Schwab office

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## **Schwab's Stock Up Nearly 13% As Cash Outflows Decelerate**

**One analyst wrote that the investment case for Schwab has been 'significantly de-risked.'**

Rob Burgess | Jul 19, 2023

Charles Schwab stock price jumped nearly 13% on Tuesday after the company announced its second quarter earnings results, which showed that its cash sorting issues are abating.

Net interest revenue was down 10% year over year to \$2.3 billion, and its net interest margin fell 32 basis points from the first quarter to 1.87%. But CFO Peter Crawford said the pace of cash outflows has decelerated.

"While anticipated client cash realignment, along with net equity buying during June, pushed cash levels lower, we observed a continued and substantial deceleration in the daily pace of cash outflows versus prior months," he said in a statement. "The continuation of this trend through the end of the quarter further strengthens our conviction that this realignment activity will inflect before the end of 2023, unlocking growth in client cash held on the balance sheet."

The firm reported net income for the quarter of \$1.3 billion, down from \$1.8 billion for the second quarter of 2022, on revenue of \$4.66 billion, down 8.4% year over year. But those results beat analysts' expectations. According to Seekingalpha.com, Schwab's non-GAAP earnings per share of \$0.75 beat expectations by 4 cents, with the revenue figure beating by \$50 million.

The past few months have been rocky for Charles Schwab as the firm navigated the fallout from the regional banking crisis.

In March, its stock lost 34% of its value in its worst month since 1987. According to Bloomberg, the firm suffered more than \$29 billion in unrealized losses on its balance sheet last year. At the same time, customers were moving their cash out of certain Schwab accounts into money funds due to higher interest rates.

And in April, Charles Schwab saw its credit ratings downgraded by S&P Global, which said the firm faces increasing interest rate risk.

"Schwab has been managing deposit outflows by using high-cost short-term funding as a stopgap," wrote Jeff Schmitt, research analyst at William Blair. "However, with cash sorting on the decline, the company has not initiated any new FHLB advances, retail CDs, or repos since May, and has instead reduced these balances by \$12 billion since May. As cash sorting abates, we believe short-term funding should continue to decline, with more aggressive pay-downs expected in 2024."

Devin Ryan, an analyst with JMP Securities, said the firm saw a net deposit increase for Schwab Advisor Services, the firm's RIA custody unit, "which is notable given that Advisor Services tends to be a leading indicator for customer cash behavior in Investor Services."

"We believe the investment case for Schwab had been cloudy over the past 18 months given the dramatic move higher in interest rates coupled with more recent anxiety through the broader banking turmoil moment, even if not fully deserved," Ryan wrote, in an analyst note. "However, we have argued the investment case has been significantly de-risked, which is valuation multiple enhancing, with the second quarter results (& commentary) representing an inflection point."

Client assets within Schwab Advisor Services were up 5% sequentially and 16% year over year to \$3.74 trillion in the second quarter.

The custodian reported net new growth in client assets of \$36 billion, down 50% from the first quarter, at \$71.3 billion. However, that figure was 4% higher than the second quarter of 2022.

Year to date, Schwab has added 159 RIA teams to its platform, and the average advisor in transition manages about \$90 million in client assets.

“In Advisor Services, we continue to be the destination of choice for breakaway brokers and broker teams of all sizes,” said Walt Bettinger, Charles Schwab’s CEO and co-chairman of the board, during Tuesday’s summer business update.

Also during Tuesday’s call, Rick Wurster, Charles Schwab president, offered an update on the ongoing TD Ameritrade conversion. A “relatively small” number of retail brokerage client accounts were converted over President’s Day weekend in February. TD Ameritrade RIAs are still slated to transition over Labor Day weekend.